THE PROBABLE CONDITION OF THE AMERICAN MONEY MARKET AFTER THE WAR IS OVER[1]

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When I promised to prepare a talk on the probable condition of the money market after this great war is over, I was hoping that I might get some light on the subject by making an inquiry into the phenomena incident to the great conflicts of the last hundred years. I regret to say that I have been disappointed.

The historical method of study, so far as I have been able to apply it, does not yield either convincing or illuminating conclusions. The world of today is very different from the world in which the Napoleonic, the Civil and the Franco-Prussian wars were staged and the wars of later date did not call all Europe to arms as the present war has done. Comparison is, therefore, difficult.

Difficulty of Forecasting

The problem contains so many unknown factors that no scientific forecast is possible. We do not know, for instance, how long the war will last, or which side will be victorious, or whether heavy indemnities will be exacted, or whether at the end the nations of the earth will lessen or increase their outlays for the maintenance and equipment of navies and armies. Furthermore, we are uncertain as to the increase in the world's stock of gold, available for use as money during the next few years. All these matters, nevertheless, possess real significance in relation to our money market.

I shall assume that the war will be over in six months from date, and that its total cost measured in our money will be at least twenty billion dollars. In this estimate I include the extraordinary expenditures which several neutral nations, such as Italy, Switzerland and Holland, have been forced to make by what has seemed to them a most threatening emergency. I assume also that at least seventy-five per cent of this vast sum will have been raised

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by the sale of bonds and by a corresponding increase in the funded indebtedness of Japan and Europe.

Decrease in World's Savings

A Belgian statistician estimates that the people of the earth save about four billion dollars a year for investment purposes. The higher interest rate now paid for capital is doubtless tempting many people to economize and increase their savings; but any such increment will probably be more than offset by the world's lessened productive capacity. Not only are many millions of able-bodied men engaged in destroying property and life, but many other millions are out of employment in all countries because there is no market for the goods they produce. Hence we are forced to the conclusion that not only is the current addition to the world's supply of loanable investment capital inadequate to finance the present war, but that the current saving is less than normal.

Effect on Bond Prices

We must conclude, further, that the price which warring nations must pay for capital will continue to rise throughout the war; and it is even conceivable that, if the war should last another year instead of merely six months, the interest yield demanded might become so high and the prices of government bonds so low that investors would get exceedingly nervous about the prospects of repudiation, and decline to turn over their savings to some, if not to all, the nations at war. What might be the possible effect upon our market if the finish of the war were brought about as the result of such financial exhaustion is a question which I do not care to contemplate at present.

In any statistical inquiry to arrive at the influence which all expenditures have upon prices of bonds and the rate of interest, it is necessary to take into account the effect which is more or less constantly exerted by an appreciation or depreciation of the monetary standard. In a period of rising prices such as the world has experienced since 1897 the general tendency of bond prices, other things being equal, is toward lower levels; while in a period of falling prices, such as we passed through after the Civil War, bonds prove a more attractive investment and their prices rise.

British Consols and Previous Wars

The Napoleonic wars came to an end during a period of falling prices; and during the next five years, that is from 1815 to 1820, England was ransacking the earth for gold in order to place her monetary standard upon a firm basis. In 1815 British consols ranged in price from 61 to 72. In 1816 they were at a lower level, the range being 53 to 65. In 1817 and 1818 they sold above 80 and never below 60. In 1819 the highest price was 79 and the lowest 64. In 1820 they fluctuated between 65 and 70. These figures possess little significance for us, nor does the fact that their level is above the average of the quotations for the last ten years of the war, for a century ago corporation bonds were an almost negligible factor in the investment market; so that government bonds were not in competition with a large mass of other securities, as they are at the present time.

The year 1871 marks the end of a decade during which capital amounting to several billions of dollars was destroyed in wars in Europe and the United States. But it was also a period of gold appreciation, which, in its relation to security prices, tended to offset the destruction of capital in the war and to make for a strong bond market. As a matter of fact, consols were practically stationary for the five years ending with 1874, but lower than they had been in 1867. In the latter year they ranged from 89 to 96, whereas in 1874 the range was from 91 to 93. In 1875 they began to rise; after 1880 they were above par until 1889, when the interest rate was reduced from 3 per cent to 2.75 per cent.

In the decade ending with 1905 a large amount of capital was wasted in war. There was our own war with Spain, costing around a billion dollars. The Russo-Japanese war, lasting eighteen months in 1904 and 1905, is estimated to have cost Japan and Russia each over one billion dollars. It cost England about one billion dollars to subdue the Boer in South Africa in the first two years of this century. All told, it is probable that at least four billion dollars was wasted in war between 1898 and 1905. This was extraordinary expenditure over and above the sums which the nations were already expending in the maintenance of their armaments.

This was a period also of rising prices, as well as of heavy war expenditures, and the bond market, as most of us remember, was steadily weakening. It is not surprising, therefore, that

British consols declined from their high-water mark of 113 in 1898 to between 85 and 91 in 1904, or that their prices have since then been steadily declining.

I think we are justified in assuming that war has been largely responsible for the high investment rate of interest which capital has been able to command in all parts of the world during the last ten years, and it seems inevitable that the tremendous waste of capital now going on in Europe must soon force the rate of interest to such a height that costs of production in general will be increased and the prices of many of the necessaries of life be raised.

Our Home Demand for Capital

We must also take into account certain imperative capital needs in our own country. For instance, there are now in existence at least half a billion of railway securities maturing this year. If we include all the railways in the United States, Mexico and Canada, it is a conservative estimate that they must raise within the next five years at least 750 million dollars to take care of their obligations which will mature within that period; and 250 million more will be needed to take care of equipment trust obligations and provide for new capital expenditures. In other words, the railways in this country will need at least one billion of new capital during the next five years. How much will be needed for industrial corporations cannot, of course, be estimated, for their needs will depend upon market conditions which cannot now be foreseen.

It is evident that the real cost of the war cannot be estimated in money or measured by the sums of money which the nations in combat will expend. The war has blocked the wheels of industry in every country on the globe. It has turned back the hands of the clock of our material or industrial civilization. It is making us all poorer because it is making us produce less and at the same time pay more for the satisfaction of our wants.

Credit Inflation

If I knew that peace were in sight and that its terms might be ratified before the next snowfall, I believe I should be justified in predicting that the governments of Europe, in order to help their people recover from the effects of the war and regain their old

standing in the world's markets, would be as ingenious and daring in their use of credit as they have been during the last eight months in their schemes and devices for financing the war. We have seen England issue between two and three hundred million of what we could call greenbacks, a legal tender government currency redeemable in gold by a private institution, the Bank of England; furthermore, England has floated an enormous war loan, and that same bank has agreed to lend against this debt, sovereign for sovereign. Here we have the possibility of a currency and credit inflation that would promise a financial millenium to any of our most ardent advocates of fiat money.

In France we find the same remarkable extension of credit. The Bank of France has increased its note issues over 50 per cent, and cities and towns throughout France have put forth unrestricted issues of paper money. The business of the country, it seems, is done entirely upon credit; the government bank has increased its holdings of gold until they now equal nearly one billion dollars, but it is evidently the policy of the bank to hold the gold of the country as a reserve and to compel the transaction of business with credit instruments.

In Germany we find the same unprecedented use of credit. By the organization of loan banks throughout the empire with the coöperation and assistance of the government and the Reichsbank, the country has been flooded with a mass of paper currency, and every man possessing any kind of property has been able to get bank credit for the support and furtherance of his business or industry.

Never at any time in the world's history have the leading civilized nations of the earth resorted to any such remarkable financial expedients. We simply do not know what the outcome will be; but we do know that there is a chance that the credit of one of these great nations may be stretched to the breaking point, and we know that a collapse of credit in any one of these nations means its defeat in war.

Government Guaranty of Industrial Securuties

It goes without saying that with the advent of peace every possible effort will be made by the people of Europe to vivify their abandoned industries and trade. Of the three factors necessary

to the production of wealth, land alone will be intact and undiminished. There will be a relative decrease in the supply of labor, but this decrease will not be so large or important as many people seem to imagine, thanks to the marvelous developments of modern surgery in the last quarter century. The really deficient factor will be capital. We may leave out of account the factories and workshops that have been destroyed, and assume that a bench or a machine is awaiting every soldier when he lays aside his uniform. Nevertheless industry and trade cannot be resumed on the old scale unless money can be got for the payment of wages and for the purchase of raw materials. I do not believe that this necessary supply of capital can quickly be obtained unless private industrial credit is reinforced by government or national credit. I am disposed, therefore, to predict that the end of the war will be followed by issues of industrial securities backed by the direct or indirect guarantee of a government. Just as our own government assisted in the construction of our Pacific railways, so I expect to see European governments, in the not far distant future, lending their aid to private enterprises.

Whence will come the money that will place Europe industrially and commercially again on her feet? There can be but one answer to this question, for there is only one country with resources and wealth great enough to be of real assistance—and that country is the United States. If Europe is to make quick recovery from the effects of the war, she must borrow capital. That capital will go to Europe not in the form of gold but in the form of foodstuffs and raw materials, and the bulk of them will go from the United States. This means, if I am right, that during the first years of peace our export of goods will be abnormally large, and that we shall sell goods mainly on credit. We shall take in payment not gold, but the guaranteed industrial securities of European nations. These securities will necessarily bear a high rate of interest, for otherwise they will make no appeal to the American investor.

Danger To The United States

If Europe does draw capital from us, what is to become of our own industries? Will our march of industrial progress be halted or can we, in some way that is without precedent, manage to convert bank credit into capital and continue the extension of our railroads

and the enlargement of our industrial plants? Here we are entirely in the realm of conjecture, for we have no idea what will be the temper or attitude of the American people or of the American banker. It is possible, however—nay, I think it even probable—that the close of the war will have a strong psychological effect. The burden of debt, anxiety and uncertainty, which now everywhere restrains enterprise, will be lifted. The business sky will be free from clouds. Once more the world will seem eager to take our surplus products at high prices, and we shall be in danger of overlooking the fact that our best customer, Europe, is buying with borrowed money. We may also overlook the fact that European purchases from us will be abnormally large for not more than two years after the end of the war, and that thereafter her people will practice the severest economies in order to get out of debt. This country will then be exposed to the same peril which destroyed its temporary prosperity in 1818 following the Napoleonic wars—namely, a flood of European imports for sale at ruinous prices. That, of course, would mean panic in the United States.

The New Banking System

I shall close with no such gloomy prospect in view. Fortunately, we now have a banking system upon which we can place some reliance. Its power to protect the business interests of the United States will certainly be tested within two years after the war is ended. Although it is not an ideal system, it is so much better than anything this country has had during the last seventy-five years that I believe we may look to it with confidence, trusting that its managers will keep business men fully warned as to the dangers that threaten them, and will be prompt and powerful in the application of measures of protection and relief.

If our federal reserve banking system had been in full operation at the beginning of last August, with power to mobilize our enormous gold reserve, there would then have been more than an even chance that New York City would have become the world's financial center, and that the American dollar would have elbowed the British sovereign out of its "place in the sun."

Finally, since it is so easy to make predictions when you don't know too much about a subject, let me call your attention to an

interesting possibility, if not probability. I have said that Europeans will come to us after capital. They will get it by the offer to us of new securities and by the resale to us of our own securities. Protests will go up from all quarters of the United States, and I shall not be surprised if societies are organized for the protection of the American dollar against foreign greed. But no tariff or tax barriers will prevent an efflux of capital if the foreigner only bids high enough. So it is quite possible that this war, besides imposing on us an abnormal rate of interest, will also work an unlooked-for miracle and transform the United States from a debtor nation into the world's commanding creditor nation. If this happens it will be an involuntary achievement on our part; and it certainly will not happen at all unless the American people have a change of heart and cultivate the favor and good will of the goddess of sane living, namely, economy.